[Review of the book Conflict of Interest: Challenges and Solutions in Business Law, Medicine and Public Policy, D.A. Moore & D.M. Cain, 2006]

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Don A. Moore, Daylian M. Cain, George Loewenstein and Max H. Bazerman (eds.), *Conflicts of Interest: Challenges and Solutions in Business, Law, Medicine and Public Policy*, Cambridge University Press, 2005. 300 p. GBP 40 (ISBN 0521844398)[1]

Many professionals face a conflict between their professional responsibilities to protect the interests of their principals or clients and their own self-interests. Auditors have a duty to provide an honest, independent opinion on the accuracy of financial statements of companies, but they might cater to the demands of their clients and accept some misrepresentation, especially if they also have the firm as a consulting client and fear that they might lose that business. Doctors that go on study trips paid by pharmaceutical companies may prescribe the drugs of those companies more frequently. Can a financial intermediary be trusted to give advice that is in the best interest of the client, or will he direct the client to that company that gives him the highest bonus? In prescribing textbooks for students, do teachers sufficiently take into account the cost that they impose on students, or do they just look at how convenient the book is for them? In writing a referee report, is an academic more inclined to accept the paper if it refers to her own work, since the citations would enhance her academic reputation? When an economist serves as an expert witness in an antitrust case, it is sufficient and acceptable that he focuses on the client's position, counting on the expert witness of the other side to bring out the counterevidence and on the adversarial process producing the truth?

The present book, a collection of papers presented at a conference at Carnegie Mellon University, discusses these issues. The editors note that academics have not had much influence on debates on these issues, which they trace to the fact that standard economic literature is not very useful in this domain. Economists classify the above settings as principal agent problems, but the simple version of that theory assumes that the agent is motivated exclusively by money. Consequently, that theory does not incorporate other regarding behavior and professional norms, which do play a role in practice, and it does not allow answering the question why such norms break down in certain circumstances. To fill the gap, the conference brought together a multidisciplinary audience, including economists, lawyers and psychologists, to

[1] Book Review, to appear in *De Economist* 4, 2006

discuss the prevalence of the problem and possible solutions. Next to an introduction by the editors, the collection contains ten papers, each being followed by a chapter with commentary. In short, the book addresses the question: what does behavioral economics have to say about this issue?

The important message of the book is that the problem may be more serious than many observers may believe. First of all, some of the chapters detail the extent to which conflicts of interests have corrupted certain professions, such as the accounting and medical professions.[2] Secondly, many professionals hold naïve psychological theories and believe that they themselves would be sufficiently strong to not be influenced and to not deviate from the professional norm. This is similar to most people believing that they are better than average car drivers; the truth is different. Thirdly, there are no easy solutions to address the problem, and traditional safeguards may perform rather poorly, or even backfire.

Existing proposals for solution fall into three categories: substantive regulation, aligning incentives and procedural regulation. Structural separation (for example prohibiting companies to do both auditing and consulting activities) falls in the first category. It is a blunt instrument, not advisable if there are synergies between the activities: separating pure academic research from policy research may not be a good idea. The incentives of the agent may be aligned more closely with the goals of the principal by means of contractual terms and liability arrangements (as, for example, proposed in the Sarbanes-Oxley Act on corporate governance in the US), but the literature shows that providing explicit incentives may undermine professional norms. Disclosure is a frequently proposed procedural regulation: the professional should disclose his interests, so as to allow the audience to discount the advice.[3] The book shows that this may be problematic as well since it may lead the advisor to give even more biased advice and since the audience typically will not discount it as much as should be; as a result disclosure may lead to even worse decisions.

[2] In 2001, more than 50% of the most cited articles in the field of medicine was financed by industry;" Meer invloed bedrijven op toponderzoek", *NRC Handelsblad*, 21 maart 2006
[3] For example, at http://www.knaw.nl/ see the KNAW "Declaration of Scientific Independence" requiring, among others, that external financiers of research be mentioned and that researchers disclose relevant interests and advisory relations.

At the core of the book is the question what motivates people. The book shows that the simplistic assumption of materialistic selfishness may not provide an appropriate starting point and that norms play a role: people may be motivated to do what they "should" do. Yet the book also shows that we should not be too optimistic: if people can choose between two situations where in the first the norm "behave fairly" applies while in the other it does not, if it serves their self-interest, people may choose to be in the second. In choosing between two textbooks, one expensive, but making the teaching load light, the other cheap but involving more work for the teacher, the teacher might choose not to inquire about the price, so as to avoid the fairness issue.

The book raises issues, cautions against simplistic solutions and shows that behavioral economics holds the promise of providing superior answers in the future. It extends an open invitation to do more research, which indeed seems worthwhile. As one of the editors writes (p. 205): "Developing and fostering a code of ethics and behavior in a profession is a slow, painstaking process. But, professionalism can deteriorate with frightening rapidity, as we have seen in recent decades. And, once the egg of professionalism has been cracked, all of the legal regulations in the world may not be able to put Humpty back together again".

Eric van Damme